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FILED
AUG 9 1955
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 104

AUSTIN F. MCFEE, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITIONER'S REPLY BRIEF

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Printed by Law Reporter Printing Co., 518 5th St., Washington, D. C.

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PETITIONER'S REPLY BRIEF

Preliminary Statement

The safeguards announced by this Court in *Holland* v. *United States,* 348 U. S. 121, 75 S. Ct. 127, 99 L. Ed. 127, were intended to minimize the danger of conviction of an innocent person by the use of the net worth method. The present case demonstrates the reasonableness of and the necessity for those safeguards. Petitioner was convicted because the trial court failed to observe and apply them.

His innocence can be demonstrated by the record before this Court.

Respondent's Brief in Opposition completely fails to answer the specific points involving the use of the net worth method which are set forth in the Petition as reasons for granting the writ and with respect to which the Government's proofs fail to meet the standards announced by this Court in the *Holland* case, *supra*.

I.

As to the "Likely Source"

There is no evidence whatever to support Respondent's contention that Petitioner's business was capable of producing much more income than was reported. The evidence is to the contrary.

Increases in net worth standing alone cannot be assumed to be attributable to currently taxable income. *Holland* v. *United States, supra,* 75 S. Ct. at p. 136. It was necessary, therefore, for the Government to produce evidence tending to show that the apparent net worth increase represented taxable income. Proof of a likely source of taxable income from which the jury could reasonably find that the net worth increases sprang is sufficient to supply this necessary element of proof. *Holland* v. *United States, supra,* p. 136.

There is no such evidence in this case. Petition pp. 11-14. Respondent has pointed to none.

Respondent's sole statement of fact in support of its contention that Petitioner's coin machine business was the likely source of the alleged net worth increase, is that the gross receipts from this source "ranged from $140,000 to $246,000 for the years 1942 to 1946 inclusive." (Br. p. 3.) Therefore, Respondent contends, this business was the likely source.

Petitioner's gross receipts from this source were as follows (R. 384):

1942	$199,494
1943	212,133
1944	195,167
1945	239,310
1946	296,679

There is not the slightest evidence from which it reasonably could be inferred that Petitioner's gross receipts from that source for the years 1945 and 1946 in issue were greater than the amounts set forth above. There was no evidence from which a jury could reasonably find that this business was capable of producing more gross income than was reported during the years 1945 and 1946. There is no evidence with respect to the size or capacity of the business to produce income except the above figures. There is no evidence of receipt of any unreported income from this business, or of opportunity to receive unreported income. There is no evidence of attempted concealment of assets, or of incorrect books of account, or of any other act or device usually employed by an evader of taxes.

Mere volume, standing alone, does not support the inference of unreported income. For example in *Holland* v. *United States, supra,* the Government showed that although the business of the Hollands apparently increased during the years in question, the reported income "fell to approximately one-quarter of the amount declared by the previous management in a comparable period." Idem, p. 136. Thus the evidence in that case indicated that the business was capable of producing more income than was reported.

But in the present case there was no such showing. Petitioner's reported income from the suspected source *increased substantially* during the two prosecution period years. From $195,167 in 1944 it increased to $239,312 in 1945 and to $296,679 in 1946 (R. 384), an increase of 22.7%

and 52% rsepectively. This does not support any inference that the business was a potential source of unreported income, for there was no collateral showing of capacity for income greater than that reported.

Furthermore, in the *Holland* case, *supra* (at p. 136), it was shown that the Holland's had access to the cash register and actually withdrew at least $12,500 therefrom which was not recorded or reported as income. In the present case, the Petitioner did not have access to the cash registers or to any other source of collections, all receipts were collected and recorded by employees, and there was no evidence showing or tending to show that Petitioner received, or had the opportunity to receive any unrecorded or unreported income from this source or from any other known source. All of the evidence, save the net worth statements alone, is consistent with Petitioner's claim that the alleged net worth increases arose not from current income but from errors in the Government's net worth computation.

Respondent does not point to any evidence which is in conflict with the foregoing statements. It merely ignores them and states that the jury could properly have concluded that many items of income had disappeared before they reached the recording stage because (br. p. 6):

(1) petitioner was the sole owner of a prosperous business,

(2) that the business was capable of producing much more income than reported,

(3) that petitioner's contention of a prior accumulation was refuted by the evidence,

(4) that petitioner failed to produce or turn over to the revenue agents the temporary collection book records.

Respondent's contention is untenable.

(a) That Petitioner was the sole owner of a prosperous business is a completely neutral element. Respondent omitted the important part of the evidence, namely that all

collections and recordations were made entirely by employees with no access thereto by Petitioner prior to due recordation. There was no evidence whatever to the contrary.

(b) There is absolutely no evidence that the business was capable of producing more income than reported. If there had been, Respondent would have pointed it out, as it did in the *Holland* case, *supra*.

(c) Petitioner's claim of a prior accumulation relates primarily to the accuracy of the Government's opening net worth statement. If he had the accumulation (which the record before this Court shows that he had) or any part thereof the opening net worth statement was erroneous. If he had no cash accumulation whatsoever, the omission of cash from the opening net worth computation was correct. But as pointed out by this Court in *Holland* v. *United States*, *supra*, therein lies one of the vulnerable features of the use of the net worth method. Mere proof of net worth increase does not establish that the apparent increase was currently taxable income. There must be additional evidence, such as proof of a likely source potentially capable of producing currently unreported income.

Therefore, whether Petitioner did or did not have a prior cash accumulation, does not in and of itself tend to establish his coin machine business as a potential or probable source of unreported income, particularly in view of the uncontroverted evidence that all collections were made and recorded by employees. This important element must be established by the Government by tangible evidence—not mere suspicion. There was no such evidence in this case.

(d) The collection books were merely corroborative evidence of facts fully covered by Petitioner's witnesses. These collection books were temporary records made by employees, similar to department store sales books, not generally preserved for years long after recordation in the

permanent books of account. There is no evidence that Petitioner himself was ever requested to produce these collection books (cf. R. 399). There is no evidence that he ever received any of such books except after due and truthful recordation thereof in the books of account (R. 399). There is no evidence that these books were in existence at the time of trial. There is no presumption that temporary records are preserved indefinitely. Common custom is to the contrary.

Surely the failure to produce old temporary records which, the evidence affirmatively established, had been truthfully recorded in the permanent books, of account, does not give rise to an inference that the collections, made and recorded solely by Petitioner's employees, were a likely source of the alleged net worth increase.

Moreover, the burden of proof was on the Government to establish a likely source. It was not incumbent upon the petitioner to establish to a mathematical certainty by corroborating evidence that the suspected source could not possibly be a likely source.

* * * * *

There is absolutely no evidence in the record to support Respondent's statement that Petitioner's business was a likely source of unreported income. In this respect, therefore, the judgment below is not supported by this necessary element of proof and, therefore, is not in accordance with the decision of this Court in *Holland* v. *United States*, *supra*.

II.

The Opening Net Worth Computation

(a) The Government failed to track down the "lead" furnished by Petitioner as to the existence of a substantial portion of the $114,000 item known to exist in 1943.

(1) Respondent does not deny in its Brief in Opposition, that the Government agents failed to track down the "lead"

furnished by Petitioner, as to the existence of a substantial amount of cash on hand at the beginning of the prosecution period, as set forth at p. 17 of the Petition. Respondent does not deny that the Foresters Club books of account as pointed out by Petitioner to the agents, would have disclosed at least $71,172 of cash available to Petitioner from that source alone but not included in the opening net worth computation. Respondent does not deny that the revenue agents ignored this lead and failed to examine these books of account which were available to them. This substantial cash amount was derived from the $114,000 item referred to by the Government agent (R. 263, 485).

Respondent does not deny that the Government agents failed to investigate the $114,000 item known by them to exist in 1943, and does not deny that this item was easily susceptible of confirmation from the sources available to them as set forth at page 18 of Petition.

Respondent does not deny that this item if investigated would have completely exonerated petitioner for the year 1945 and would have thoroughly discredited the Government's case for 1946.

Respondent's refuge on this point consists merely in quoting from the Court of Appeals opinion on the original appeal. The Court of Appeals said that the only affirmative evidence concerning the $114,000 transaction was the testimony of R. E. McDonnell, a witness called by Petitioner (br. p. 6).

Thus it appears, not only from the record but also from the Court of Appeals opinion, that the record is devoid of any showing that the Government agents adequately investigated and tracked down this important lead, which as pointed out on page 17 and 18 of the Petition herein was easily susceptible of being checked.

The Court of Appeals took the view in its original opinion that it was incumbent upon the petitioner to establish the existence of this available cash fund, and since McDonnell's

testimony was viewed as being highly questionable,* it resolved the issue against the Petitioner. On reconsideration the court, in a per curiam opinion, merely reaffirmed its former opinion in toto.

But this Court held in the *Holland* case that the burden of proof is on the Government, not the accused, and that it was incumbent upon the Government to make a fair and reasonable investigation from available sources, of important leads bearing upon the existence of assets includible in the opening net worth computation.

In this respect, therefore, the judgment of the court below is not supported by this necessary element of proof and therefore is not in accordance with the decision of this Court in *Holland* v. *United States, supra.*

(2) There is no question but that this $114,000 item existed. The Government agents knew about it (R. 263). A photostat of the entire account of this item is on file with this Court and is part of the record certified to this Court by the Court of Appeals (R. 484).

Respondent takes the position that this evidence cannot be relied upon at this stage of the proceeding (br. p. 4, note 2).

Petitioner takes the position that the Government's case was defective in that the Government agents failed to take reasonable steps to track down this important lead, which was readily susceptible of investigation and which would have thoroughly discredited the Government's net worth computations.

The burden was on the Government to establish that it had taken this reasonable precaution. Cf. *Holland* v. *United States, supra,* 75 S. Ct. at p. 135. The Government's failure to take this precaution is not cured by petitioner's failure

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* The photostat of the account of the $114,000 item on file with this Court (R. 484) shows that McDonnell's testimony was substantially correct.

to demonstrate his innocence. The account of this transaction clearly confirms what this Court said in the *Holland* case, namely that a failure to track down an important lead readily susceptible of investigation may result in "serious injustice," and such failure may raise a doubt as to the accuracy of the net worth computation sufficient to warrant a judgment of acquittal. (Idem 75 S. Ct. at p. 135).

(b) Respondent does not deny Petitioner's contention that there was no substantial independent evidence corroborating Petitioner's alleged statement that the $114,000 item represented a turnover.

The Government agents testified that they included none of the $114,000 item on hand in 1943 as an asset in the opening net worth computation because Petitioner told them it was a sum total of a "turnover" (Petition, pp. 18-20). This was an important element of proof for if it was not a turnover, the proceeds of the entire $114,000 item were erroneously excluded.

There was no independent corroboration of this alleged statement (Petition, pp. 18-21). The statement probably was never made at all because it was not true.

Respondent's Brief in Opposition makes no claim or contention that there was any corroboration whatever of this important alleged statement. It does not point to any corroborative evidence, for there was none.

In this respect therefore the judgment of the Court of Appeals is not supported by this necessary element of proof and therefore is not in accordance with the decisions of this Court in *Opper* v. *United States*, 348 U. S. 84, 75 S. Ct. 158, 164, 99 L. Ed. 104 and *Smith* v. *United States*, 348 U. S. 147, 75 S. Ct. 194, 199, 99 L. Ed. 143.

III.

There was no evidence supporting an inference of wilfulness. The admittedly erroneous instructions as to intent were highly prejudicial. They were not in accordance with the rule recognized by this Court in Holland v. United States.

Respondent admits that the trial court's instructions on presumptive intent were erroneous but contends that the error was harmless because cured by other instructions (br. p. 8).

The erroneous instructions (Petition p. 24) were particularly onerous because there was no evidence of wilfulness and any inference of wrongful intent necessarily was itself based on inference thrice removed from fact.

(1) The jury was required to infer that because the Government agents said they did not know the source of certain expenditures that such source represented a current increase in net worth.

(2) Then the jury was required to infer that the inferred current increase in net worth represented currently taxable income.

(3) Then the jury was required to infer that because Petitioner did not report the inferred income in his returns, that his omission was wilful.

(4) Then the Court told the jury that Petitioner's wilful failure to report the inferred income in his returns gave rise to a presumption that Petitioner intended to defeat the tax.

In the *Holland* case this Court recognized the rule that wilfulness cannot be inferred from the mere understatement of income but stated that a consistent pattern of under-reporting large amounts of income and of failure on Petitioner's part to include all of their income in their books and records was sufficient to support an inference of wilfulness, 75 S. Ct. at p. 137.

But in the present case there was no evidence of a consistent pattern of understatement of income and there was no evidence of a failure to include all of Petitioner's income in his books and records. The inference of wilfulness was premised solely upon the series of inference on inference set forth above.

Petitioner submits not only that the erroneous instruction was particularly harmful but that on the face of the entire record that was no evidence from which the jury could reasonably infer an intent to defeat the tax. In this respect the judgment of the Court of Appeals was not in accordance with the decision of this Court in the *Holland* case.

CONCLUSION

Holland v. *United States, supra,* sets forth certain precepts calculated to standardize throughout the several Circuits the use of the net worth method of proof in criminal prosecutions. Such standardization is not achieved if one Circuit may arbitrarily disregard such precepts by generalizations giving lip service thereto not supported by the record. The line of demarcation between a conviction based on proofs conforming to those standards and one not conforming thereto has not been concretely drawn by this Court. This case provides a vehicle for such an authoritative declaration. Petitioner submits that the issues are broad enough and of sufficient general application to warrant the granting of the writ.

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